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BEFORE THE ARIZONA CORPORATION COMMISSION
Arizona Corporation Commission

COMMISSIONERS

DOCKETED

JUL -8 2008

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

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IN THE MATTER OF THE APPLICATION OF
TUCSON ELECTRIC POWER COMPANY
FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES
DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE
OF ITS OPERATIONS THROUGHOUT THE
STATE OF ARIZONA.

DOCKET NO. E-01933A-07-0402

IN THE MATTER OF THE FILING BY
TUCSON ELECTRIC POWER COMPANY TO
AMEND DECISION NO. 62103.

DOCKET NO. E-01933A-05-0650

NOTICE OF FILING

Staff of the Arizona Corporation Commission hereby provides notice of filing the Rebuttal
Testimonies of Barbara Keene and Ralph Smith in the above-referenced matter.

RESPECTFULLY SUBMITTED this 8th day of July, 2008.

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REBUTTAL TESTIMONY
SUPPORTING THE SETTLEMENT AGREEMENT
OF

RALPH C. SMITH

BARBARA E. KEENE

DOCKET NO. E-01933A-07-0702

DOCKET NO. E-01933A-05-0650

**IN THE MATTER OF THE APPLICATION OF
TUCSON ELECTRIC POWER COMPANY FOR
THE ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES DESIGNED TO REALIZE
A REASONABLE RATE OF RETURN ON THE FAIR VALUE
OF ITS OPERATIONS THROUGHOUT THE STATE
OF ARIZONA**

**IN THE MATTER OF THE FILING BY TUCSON
ELECTRIC POWER COMPANY TO AMEND
DECISION NO. 62103**

JULY 08, 2008

Smith

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF)
TUCSON ELECTRIC POWER COMPANY FOR)
THE ESTABLISHMENT OF JUST AND)
REASONABLE RATES AND CHARGES)
DESIGNED TO REALIZE A REASONABLE)
RATE OF RETURN ON THE FAIR VALUE OF)
ITS OPERATIONS THROUGHOUT THE STATE)
OF ARIZONA)

DOCKET NO. E-01933A-07-0402

IN THE MATTER OF THE FILING BY TUSCON)
ELECTRIC POWER COMPANY TO AMEND)
DECISION NO. 62103.)

DOCKET NO. E-01933A-05-0650

REBUTTAL TESTIMONY SUPPORTING THE SETTLEMENT AGREEMENT

OF

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

JULY 08, 2008

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EXECUTIVE SUMMARY
REBUTTAL TESTIMONY IN SUPPORT OF SETTLEMENT OF RALPH C. SMITH
TUCSON ELECTRIC POWER COMPANY
DOCKET NO. E-01933A-07-0402

My rebuttal testimony in support of the settlement responds to the testimony of RUCO witness William A. Rigsby.

My rebuttal testimony addresses these aspects of the settlement agreement to which RUCO has taken issue:

- Reconciliation of Staff direct filing with Settlement Agreement
- The amounts of Fixed CTC True-Up Revenues and the presentation of the base rate increase in the Settlement Agreement
- The Base Cost of Fuel and Purchased Power
- The Purchased Power and Fuel Adjustment Clause
- Depreciation and Cost of Removal Related Issues
- Springerville Unit 1 related issues

I also address a technical correction to Section 7 of TEP's Rules and Regulations concerning Line Extensions that Staff believes should be made.

1 **I. INTRODUCTION**

2 **Q. Please state your name, position, and business address.**

3 A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC,
4 15728 Farmington Road, Livonia, Michigan 48154.

5
6 **Q. Are you the same Ralph C. Smith who previously submitted prefiled direct testimony**
7 **on behalf of the Arizona Corporation Commission (“ACC” or “Commission”)**
8 **Utilities Division Staff (“Staff”) that was filed on February 29, 2008 and direct**
9 **testimony in support of the Settlement Agreement filed on July 2, 2008 in this**
10 **proceeding?**

11 A. Yes.

12
13 **Q. What issues does your rebuttal testimony address?**

14 A. My rebuttal testimony responds to the responsive direct testimony of William A. Rigsby,
15 who filed on behalf of the Residential Utility Consumer Office (“RUCO”). My rebuttal
16 testimony addresses these aspects of the settlement agreement to which RUCO has taken
17 issue:

- 18 ○ Reconciliation of Staff direct filing with Settlement Agreement
- 19 ○ The amounts of Fixed CTC True-Up Revenues and the presentation of the base
- 20 rate increase in the Settlement Agreement
- 21 ○ The Base Cost of Fuel and Purchased Power
- 22 ○ The Purchased Power and Fuel Adjustment Clause
- 23 ○ Depreciation and Cost of Removal Related Issues
- 24 ○ Springerville Unit 1 related issues

25 I also address a technical correction to Section 7 of TEP’s Rules and Regulations
26 concerning Line Extensions that Staff believes should be made.

1 **II. RESPONSE TO RUCO WITNESS WILLIAM RIGSBY**

2 **Q. Do you have any initial comments concerning Mr. Rigsby's testimony?**

3 A. Yes. I was puzzled and surprised at the general tone of RUCO's testimony, including
4 RUCO's abundant use of terms such as "false impression,"¹ "false premise,"² "artificially
5 and misleadingly,"³ etc. The tone of RUCO's testimony surprised me because this was a
6 very open settlement negotiation process. RUCO was invited to participate, and did in
7 fact attend the discussions and offer comments. In my opinion, RUCO could have
8 presented its concerns more respectfully, and not attempted to cast aspersions on the
9 settling parties. The Settlement Agreement was achieved in a very open process, by the
10 signing parties who had engaged over several weeks in difficult and intensive
11 negotiations. In my opinion, the Settlement Agreement was able to resolve in a fair and
12 reasonable manner a wide range of disputed issues.

13
14 **Q. In your opinion, is the settlement agreement misleading in its presentation of the
15 amount of the rate increase?**

16 A. No. A clear reading of the Settlement Agreement, including both paragraphs 2.3 and 2.4,
17 shows that the base rate increase has been presented two ways: (1) in paragraph 2.3 in
18 terms of the \$47.1 million increase above TEP's current rates, which include Fixed
19 CTC/True-Up Revenue; and (2) in paragraph 2.4 in terms of the \$136.8 million increase
20 over TEP's current revenue without Fixed CTC of \$691.5 million.

¹ Rigsby responsive testimony, page 6, line 19

² Id, page 7, line 4

³ Id, page 8, line 2

1 *Reconciliation of Staff direct filing with Settlement Agreement*

2 **Q.** At page 9 of his testimony RUCO witness Rigsby notes that “the Settlement
3 Agreement represents an amount almost \$100 million greater than originally
4 recommended by Staff. He claims that “none of the documents explain the logic
5 behind the Settlement concessions and why this \$100 million rate increase is fair,
6 reasonable, and in the public interest.” Please respond.

7 **A.** The Settlement Agreement does represent an amount that is substantially higher than
8 originally recommended by Staff. My direct testimony in support of the settlement
9 quantified and explained the logic behind the major dollar differences. I also provided a
10 detailed reconciliation in Attachment RCS-7, and included a complete copy of my March
11 10, 2008 deposition transcript in Attachment RCS-8. Those items, coupled with the
12 Settlement Agreement itself, and the testimony submitted by Staff and the other signing
13 parties, I believe, do explain why the settlement is in fair, reasonable and in the public
14 interest.

15
16 In terms of the revenue requirement concessions made by Staff, RUCO witness
17 Rigsby appears to have singled out two areas, Depreciation and Springerville Unit 1
18 related issues. I will address those issues in additional detail in subsequent sections of my
19 Rebuttal Testimony.

20
21 *Fixed CTC True-Up Revenues and the Presentation of the Base Rate Increase in the*
22 *Settlement Agreement*

23 **Q.** What amount of Fixed CTC Revenue did TEP record in the test year ended
24 December 31, 2006?

25 **A.** As shown on Settlement Exhibit No 2, page 2 of 5, during the test year ended December
26 31, 2006, TEP had approximately \$89.64 million of Fixed CTC Revenue.

1 **Q. Does Staff consider the Fixed CTC revenue a permanent part of TEP's rates, as**
2 **alleged by RUCO witness Rigsby on page 7, line 5 of his testimony in opposition to**
3 **the settlement?**

4 A. No. As shown on Settlement Exhibit No 2, page 2 of 5, the Fixed CTC revenue was
5 removed in TEP's filing and in Staff's direct filing, and in the Settlement Agreement. The
6 reason the Fixed CTC revenue was removed was that it was expiring and was non-
7 recurring.

8
9 **Q. At page 7 of his testimony RUCO witness Rigsby claims that: "The \$47.1 million**
10 **purported increase of 6% presents a false impression because it is based on the false**
11 **premise that the fixed CTC is a permanent part of rates rather than a temporary**
12 **surcharge that was fully recovered earlier this year." Please respond.**

13 A. Mr. Rigsby's statement to the effect that the Settlement Agreement "is based on the false
14 premise that the fixed CTC is a permanent part of rates" is simply not accurate. Contrary
15 to Mr. Rigsby's statement, neither Staff and, to the best of my knowledge, none of the
16 other signing parties has represented "that the fixed CTC is a permanent part of rates
17 rather than a temporary surcharge that was fully recovered earlier this year." Staff
18 recognizes that the Fixed CTC expires upon the collection of approximately \$450 million
19 by TEP. Staff also recognizes that the Commission in Decision No. 69568 specified that
20 TEP may continue to collect True-Up Revenue. As a result of that Decision, the revenues
21 being paid by TEP customers have thus continued to include True-Up Revenue.

22
23 **Q. In order to be fully informative as to the amount of the base rate increase, how has**
24 **the Settlement Agreement presented such information?**

25 A. The parties deemed it appropriate to show explicitly in the Settlement Agreement the
26 approximate base rate revenue increases from two different perspectives: (1) as an

1 increase from TEP's current revenues including Fixed CTC/True-Up Revenue, and (2) as
2 an increase from TEP's revenue excluding Fixed CTC/True-Up Revenue.
3

4 **Q. Where is this information stated in the Settlement Agreement?**

5 A. It is stated in paragraphs 2.3 and 2.4 on page 6 of the Settlement Agreement. Both
6 paragraphs 2.3 and 2.4 of the Settlement Agreement specify the amount of base rate
7 revenue that is provided for in the agreement of approximately \$828.2 million.
8

9 Paragraph 2.3 in the Settlement Agreement states that the base rate increase is
10 approximately six percent, calculated on TEP's existing base rates which include revenue
11 for Fixed CTC. However, this merely recognizes that such revenue is part of TEP's
12 current rates. It does not imply that the signing parties have represented that Fixed
13 CTC/True-Up Revenue is a permanent part of TEP's rates.
14

15 **Q. Are RUCO witness Rigsby's claims of "false impression" (page 7) largely dispelled
16 by carefully looking at both paragraphs 2.3 and 2.4 of the Settlement Agreement?**

17 A. I believe so. On page 7, lines 1-11 of his testimony, Mr. Rigsby appears to focus only on
18 the information presented in paragraph 2.3 of the Settlement Agreement and not on the
19 additional information presented in paragraph 2.4 of that Agreement, which in fact has
20 presented the amount of base rate increase over the amount of TEP's current revenue
21 without Fixed CTC.
22

23 Paragraph 2.4 clearly states that the amount of base rate revenue increase is
24 approximately \$136.8 million over TEP's adjusted current base rates without Fixed CTC
25 of \$691.5 million. While paragraph 2.4 states these amounts in dollars rather than as a
26 percentage, the information about the dollar amount of increase and the amount of TEP's

1 revenue excluding Fixed CTC listed there is clear and explicit. If someone wanted to
2 calculate a percentage increase in base rates using the information stated in paragraph 2.4
3 of the Settlement Agreement, they could easily do the calculation by either dividing the
4 \$828.2 million base rate revenue provided for in the settlement by TEP's adjusted current
5 base rates without Fixed CTC of \$691.5 million. An alternative would be to divide the
6 base rate revenue increase specified in paragraph 2.4 of \$136.8 million by TEP's adjusted
7 current base rates without Fixed CTC of \$691.5 million. Either way, the base rate revenue
8 increase, computed on that basis, is approximately 19.8 percent.
9

10 Mr. Rigsby's claim on page 7 that the Settlement Agreement attempts to create a
11 "false impression" or is misleading in presenting the base rate increase only as a six
12 percent impact is inaccurate when one reviews the contents of the Settlement Agreement
13 itself, including the information presented in paragraph 2.4 of the Settlement Agreement.
14

15 In summary, a clear reading of the Settlement Agreement, including both
16 paragraphs 2.3 and 2.4, shows that the base rate increase has been presented two ways: (1)
17 in paragraph 2.3 in terms of the \$47.1 million increase above TEP's current rates, which
18 include Fixed CTC/True-Up Revenue; and (2) in paragraph 2.4 in terms of the \$136.8
19 million increase over TEP's current revenue without Fixed CTC of \$691.5 million.
20 Similar information is also presented in the Settlement Agreement in Exhibit No. 2, page 5
21 of 5, which also shows the \$136.8 million increase over TEP's current revenue without
22 Fixed CTC, the \$691.5 million of test year adjusted retail revenue, the \$828.2 million total
23 base rate revenue, the test year adjusted sales, and the average retail rate produced by the
24 settlement of 8.89 cents per kWh. Mr. Rigsby's allegations that the signing parties have
25 attempted to be misleading about the amount of base rate increase over TEP's current
26 revenues excluding Fixed CTC are without merit.

The Base Cost of Fuel and Purchased Power

Q. At page 7-8, Mr. Rigsby criticizes the Settlement Agreement for using a base cost of fuel of \$0.028896 per kWh, apparently because that is lower than the base cost of fuel and purchased power of \$0.033000 per kWh in TEP's original filing. Please respond.

A. The \$0.028896 per kWh base cost of fuel and purchased power reflected in the Settlement Agreement reflects Staff's adjustments to fuel and purchased power costs, which were accepted by the parties to the Settlement Agreement. A calculation of the \$0.028896 per kWh is shown on Settlement Exhibit No. 4. Attachment RCS-9 to my Rebuttal Testimony shows the Staff adjustments that were accepted in the Settlement Agreement which result in the base cost of fuel and purchased power.

Q. Please explain Attachment RCS-9.

A. Attachment RCS-9, page 1 of 2, reproduces Settlement Exhibit No. 4, which shows the calculation of the base cost of fuel and purchased power. I have added a "differences" column, which shows the differences between TEP's originally filed and Staff's adjusted total expenses in the relevant accounts. Those differences total \$41.769 million. Attachment RCS-9, page 2, shows the Staff adjustments to fuel and purchased power expense. Staff had three adjustments that are incorporated into the Settlement Agreement, which affected the base cost of fuel and purchased power. Those adjustments are also summarized below for ease of reference:

Staff Adjustments Affecting PPFAC Accounts	No.	Fuel Expense	Purchased Power - Demand	Purchased Power - Energy
		Acct. 501	Acct. 555-D	Acct. 555-E
Luna Plant	C-2		\$ (15,960)	
San Juan Coal Contract	C-4	\$ (9,884)		
PPFAC Adjustment	C-19	\$ (12,286)	\$ (934)	\$ (2,705)
Total Staff Adjustments Affecting PPFAC Accounts 501, 547, 555 and 565		\$ (22,170)	\$ (16,894)	\$ (2,705)

Reference: Attachment RCS-2 to Staff witness Ralph Smith's direct testimony

1 Each of these adjustments was addressed in my direct testimony. I will briefly summarize
2 the reasons for each adjustment here.

3
4 Staff Adjustment C-2 reversed TEP's proposed net operating income adjustment
5 related to the Luna Plant Facility, wherein TEP attempted to treat Luna as a market-based
6 power purchase. Staff had reflected Luna in rate base at original cost. TEP had proposed
7 to adjust Luna Plant O&M expense to a "market rate" and to adjust purchased power
8 demand cost to a market rate. Staff recommended that TEP's originally proposed
9 treatment of Luna be rejected. The result of Staff's adjustments is to essentially include
10 the Luna Plant and related O&M expense in rates at cost. This adjustment is related to
11 Staff Adjustment B-2, which effectively includes the Luna Plant in rate base at TEP's
12 recorded cost as of December 31, 2006, the end of the test year.

13
14 Staff Adjustment C-4 removed \$9.884 million from fuel expense related to the San
15 Juan coal contract. The reasoning for this removal was addressed in the direct testimony
16 of Staff witness Emily Medine filed on February 29, 2008.

17
18 Staff Adjustment C-19 reversed the \$15.925 million increase to fuel and purchased
19 power expense that TEP had proposed related to TEP's original proposal for a power
20 supply adjustor. As described elsewhere in my February 29, 2008 direct testimony, TEP
21 had proposed to adjust 2006 test year fuel and purchased power expense based on a
22 projection of 2009 expenses. TEP filed its direct case using a forecast of 2009 fuel and
23 purchased power expense. TEP also proposed to have no PPFAC rate in 2009, but to have
24 a PPFAC become effective April 1, 2010. The original proposal by TEP to use forecasted
25 2009 fuel and purchased power costs in a 2006 test year would have created an additional
26 base rate revenue deficiency of approximately \$15.925 million related to this adjustment

1 alone. Rather than create such an additional base rate revenue deficiency in the current
2 case, Staff reversed this TEP adjustment and made TEP's PPFAC effective for fuel and
3 purchased power cost incurred after January 1, 2009. As such, fluctuations in TEP's fuel
4 and purchased power costs occurring after January 1, 2009 above or below the amount
5 reflected in base rates established in this proceeding would be addressed through the
6 operation of the PPFAC, rather than through an additional base rate increase.

7
8 **Q. Does the Settlement Agreement clearly state what base cost of fuel and purchased**
9 **power is being used?**

10 A. Yes. Contrary to RUCO witness Rigsby's testimony at pages 7-8 that there is something
11 artificial or misleading about the base cost of fuel and purchased power in the Settlement
12 Agreement, paragraph 3.4 on page 7 of the Settlement Agreement clearly states that: "The
13 average base cost of fuel and purchased power reflected in base rates shall be set at
14 \$0.028896/kWh, as calculated in Exhibit 4." There is nothing artificial or misleading
15 about this.

16
17 **Q. Does the Settlement Agreement clearly show how the base cost of fuel and purchased**
18 **power being used was calculated and that it is different from what TEP had**
19 **originally proposed?**

20 A. Yes. Contrary to RUCO witness Rigsby's testimony, no one has attempted to
21 misrepresent or create a false impression about the base cost of fuel and purchased power
22 in the Settlement Agreement. Settlement Exhibit 4 clearly shows the derivation of the
23 \$0.028896/kWh and clearly shows that it is different than the amount originally calculated
24 by TEP.

25

1 **Q. What accounts are included in the determination of the base cost of fuel and**
2 **purchased power?**

3 A. As shown on Settlement Exhibit No. 4, the following accounts are included in the
4 determination of base cost of fuel and purchased power: Accounts 501, 547, 565 and
5 555.⁴ Settlement Exhibit No. 4 shows the adjusted expenses in these accounts in TEP's
6 original filing that were used to derive the TEP filed amount of \$0.033000 per kWh. It
7 also shows the Staff adjusted amounts used to derive the \$0.028896 per kWh base cost of
8 fuel and purchased power mentioned by Mr. Rigsby on page 7 of his testimony.

9
10 **Q. At page 7, lines 14-15, Mr. Rigsby claims that: "The Company's and RUCO's**
11 **original revenue requirement positions were based on a base cost of fuel and**
12 **purchased power of \$.033 per kWh." What information has Mr. Rigsby provided or**
13 **cited in support of his assertion that RUCO's original revenue requirement positions**
14 **were based on a base cost of fuel and purchased power of \$.033 per kWh?**

15 A. None. Mr. Rigsby has neither provided or cited any information in support of his
16 assertion that RUCO's original revenue requirement positions were based on a base cost
17 of fuel and purchased power of \$.033 per kWh.

18
19 **Q. Do adjustments to expenses in Accounts 501, 547, 555 and 565 affect the base cost of**
20 **fuel and purchased power?**

21 A. Yes. We have established that TEP originally proposed a base cost of fuel and purchased
22 power of \$0.033 per kWh, and that Staff's adjustments to expenses and the agreement of
23 the signing parties resulted in a \$0.028896 per kWh base cost of fuel and purchased power
24 in the Settlement Agreement.

25

⁴ These are the same accounts specified in Settlement Exhibit 6, which presents the PPFAC Plan of Administration.

1 **Q. In its February 29, 2008 direct filing, did RUCO propose adjustments to TEP's filed**
2 **expenses in any of the accounts used in the determination of the base cost of fuel and**
3 **purchased power?**

4 A. Yes. A review of RUCO witness Rodney Moore's Exhibit RLM-8 reveals that RUCO
5 did, in fact, recommend a number of adjustments which affected one or more of these
6 accounts that are used in the determination of the base cost of fuel and purchased power.

7
8 **Q. In its February 29, 2008 direct filing, if RUCO did in fact propose adjustments to**
9 **TEP's filed expenses in one or more of the accounts that are used in the**
10 **determination of the base cost of fuel and purchased power, how could Mr. Rigsby**
11 **claim on page 7, lines 14-15 of his testimony that: "The Company's and RUCO's**
12 **original revenue requirement position were based on a base cost of fuel and**
13 **purchased power of \$.033 per kWh."?**

14 A. Without support, this assertion by Mr. Rigsby appears to be questionable and perhaps
15 inaccurate. Clearly TEP's original filing was based on a base cost of fuel and purchased
16 power of \$.033 per kWh. However, if RUCO proposed adjustments to TEP's filed
17 expenses in one or more of the accounts that are used in the determination of the base cost
18 of fuel and purchased power, as appears to be the case from a review of RUCO witness
19 Rodney Moore's Exhibit RLM-8, it is difficult to see how RUCO's original revenue
20 requirement position could have been based on a base cost of fuel and purchased power of
21 \$.033 per kWh, which would have been exactly the same as in TEP's original filing.
22 Perhaps Mr. Rigsby's characterization on page 7 does not present an accurate "apples-to-
23 apples" portrayal of RUCO's original position regarding the base cost of fuel and
24 purchased power.

1 Q. How could RUCO witness Rigsby purport to make an “apples-to-apples”
2 comparison on page 7 if he has not accurately portrayed RUCO’s original position
3 regarding the base cost of fuel and purchased power?

4 A. Mr. Rigsby’s testimony does not provide an answer to this question.
5

6 *The Purchased Power and Fuel Adjustment Clause*

7 Q. At page 7, lines 19-21, of his testimony, RUCO witness Rigsby claims that: “... the
8 Settlement Agreement contains a PPFAC that will allow TEP to recover its actual
9 cost of fuel and purchased power no matter what it turns out to be ...” Has Mr.
10 Rigsby accurately characterized the PPFAC?

11 A. I don’t believe so. The PPFAC Plan of Administration (“POA”) provided as Settlement
12 Exhibit No. 6 specifically provides for a review of TEP’s actual costs for reasonableness
13 and prudence and provides for adjustments and refunds, if necessary, if such costs are not
14 incurred reasonably and prudently. Contrary to Mr. Rigsby’s assertion that the PPFAC
15 “will allow TEP to recover its actual cost of fuel and purchased power no matter what it
16 turns out to be,” the PPFAC does in fact contain provisions for review, verification and
17 audit, including, but not limited to Section 6, Verification and Audit; Section 8,
18 Compliance Reports; and Section 9, Allowable Costs. For example, as specified in the
19 last sentence on page 8 of the POA: “Any costs flowed through the PPFAC are subject to
20 refund, if those costs are found to be imprudently incurred.” Additionally, Section 6, on
21 page 6 of the POA provides that:

22
23 *The amounts charged through the PPFAC will be subject to periodic audit to*
24 *assure their completeness and accuracy and to assure that all fuel and purchased*
25 *power costs were incurred reasonably and prudently. The Commission may, after*
26 *notice and opportunity for hearing, make such adjustments to existing balances or*
27 *to already recovered amounts as it finds necessary to correct any accounting or*
28 *calculation errors or to address any costs found to be unreasonable or imprudent.*

1 *Such adjustments, with appropriate interest, shall be recovered or refunded in the*
2 *True-Up Component for the following year (i.e. starting the next April 1.)*

3
4 Consequently, if TEP's actual cost of fuel and purchased power was incurred
5 unreasonably or imprudently, the POA provides for adjustments and refunds.

6
7 **Q. At page 7, lines 13, through page 8, line 4, of his testimony, and on his Exhibit WAR-**
8 **1, RUCO witness Rigsby attempts to add \$38 million to the "ACC Staff As-Filed"**
9 **and "Settlement Agreement" amounts. Please respond.**

10 A. Mr. Rigsby's testimony does not discuss or rebut any of Staff's specific adjustments to
11 TEP's expenses in the relevant accounts that have impacted the base cost of fuel and
12 purchased power. It is possible that Mr. Rigsby may not understand the basis of Staff's
13 specific adjustments to TEP's expenses in the accounts that are included in the base cost
14 of fuel and purchased power and in the PPFAC. Mr. Rigsby's apparent assumption that
15 every dollar of expense adjusted by Staff in the test year base cost of fuel and purchased
16 power automatically results in an equal dollar of increase in the PPFAC is erroneous
17 because he is comparing costs from two different periods. The specific test year pro
18 forma expenses that were originally proposed by TEP and were adjusted in Staff's filing
19 will not necessarily reoccur in the future. Rather than assume that there is some kind of
20 \$38 million shift in expenses from test year costs and into future PPFAC rates, as Mr.
21 Rigsby apparently does, the Commission should ask these two questions:

22
23 (1) Was the base cost of fuel and purchased power in the Settlement Agreement
24 determined reasonably and using accurate information from the rate case?

25 (2) Is the PPFAC provided for in the Settlement Agreement reasonable?

26 If the answer to both of these questions is "yes," as I submit it should be, then the
27 assumptions made by Mr. Rigsby from which he derives his presupposed conclusions of

1 “fallacies” etc.⁵ are irrelevant and unhelpful to a proper evaluation of the reasonableness
2 of the Settlement Agreement.
3

4 **Q. At page 18, lines 1-7, RUCO witness Rigsby claims that the PPFAC proposed for**
5 **TEP is deficient because it does not include a provision for a 90/10 sharing between**
6 **ratepayers and shareholders of fuel and purchased power costs in excess of the base**
7 **rate cost. Please respond.**

8 A. In the Arizona Public Service Company rate case, Docket No. E-01345A-05-816, Staff
9 had proposed a Plan of Administration for a revised APS Power Supply Adjustment
10 Mechanism (“PSA”) that did not include a 90/10 sharing mechanism. The Commission
11 adopted a 90/10 sharing provision for APS’s PSA. However, in the recent UNS Electric
12 rate case, the Commission adopted a PPFAC for that electric utility that did not include a
13 90/10 sharing provision. As described in my direct testimony in this proceeding at pages
14 139-140, Staff has not recommended an APS-type 90/10 sharing provision in the TEP
15 PPFAC for the following considerations:
16

17 *Staff recognizes that such sharing mechanisms can provide an incentive to utilities*
18 *in procuring fuel and purchased power under the right circumstances. Also, Staff*
19 *recognizes that the circumstances are somewhat similar for TEP and APS.*
20 *However, rather than apply an APS-type 90/10 sharing provision in the TEP*
21 *PPFAC, Staff has attempted to develop other provisions of the PPFAC to provide*
22 *appropriate incentives and to help align the interests of TEP and ratepayers with*
23 *respect to items included in the PPFAC. Staff believes this type of approach is*
24 *preferable to the APS-type 90/10 sharing provision. One of Staff’s primary*
25 *concerns about an APS-type 90/10 sharing mechanism is that it tends to function*
26 *as a “blunt instrument” and may not be providing appropriate incentives. It could*
27 *even function to harm ratepayers under certain circumstances.*

⁵ See, e.g., Rigsby testimony, page 8k, lines 2, 6, and 10, etc.

1 Consequently, Staff does not share RUCO's view that the absence of that type of sharing
2 mechanism in the TEP PPFAC constitutes a deficiency or a flaw in the Settlement
3 Agreement.

4
5 ***Depreciation and Cost of Removal Related Issues***

6 **Q. At pages 11-13 of his responsive direct testimony RUCO witness Rigsby discusses**
7 **two adjustments related to Accumulated Depreciation, where RUCO had presented a**
8 **similar position to a Staff position that was not adopted in the Settlement Agreement.**
9 **At page 15, RUCO witness Rigsby addresses the Settlement's related \$21.6 million**
10 **increase in Depreciation Expense for prospective cost of removal accruals on TEP's**
11 **generation plant, which was in excess of TEP's original request. Please explain why**
12 **Staff agreed to this treatment of the Accumulated Depreciation and Depreciation-**
13 **rate related issues.**

14 **A. Staff believes that the Settlement Agreement's treatment of the depreciation issues results**
15 **in an overall settlement that is fair, reasonable and in the public interest. As I explained in**
16 **my direct testimony in support of the settlement, it is unlikely that a settlement could have**
17 **been achieved without reaching a compromise on these issues.**

18
19 **Q. Does Mr. Rigsby's discussion of those issues acknowledge all of the relevant**
20 **testimony?**

21 **A. No. Mr. Rigsby's discussion of these issues refers only to the position of Staff and RUCO**
22 **concerning these adjustments. However, the two adjustments to Accumulated**
23 **Depreciation were also addressed in TEP's rebuttal testimony and were a subject of some**
24 **considerable discussion during my March 10, 2008 deposition.⁶ Those additional sources,**

⁶ See Attachment RCS-8 to my June 11, 2008 testimony.

1 which are not acknowledged by Mr. Rigsby, present TEP's concerns about the merits of
2 the Accumulated Depreciation adjustments that were presented by Staff and RUCO.

3
4 **Q. Could a reasonable settlement have been reached in this case without considering**
5 **TEP's litigation position on these issues?**

6 A. No. In reaching a settlement in a case as complex as the current TEP rate case is, parties
7 on all sides had to consider carefully the various litigation positions and had to work
8 toward reasonable compromises wherever possible. Staff recognizes that, if Staff's
9 litigation position were to adopted, TEP could potentially have to write-off large amounts
10 on its balance sheet or restate its financials. The settlement agreements crafts a solution
11 that addresses Staff's concern about TEP's past under-accruals in Accumulated
12 Depreciation by providing for larger prospective accruals for generation-related cost of
13 removal during the rate moratorium period. As a result of process Settlement process, a
14 compromise was reached that resulted in eliminating those two rate base adjustments from
15 the derivation of the Settlement rate base, and which addressed, in this alternative and
16 prospective manner, the concerns that TEP's Accumulated Depreciation balance was
17 understated due to the factors described in my direct testimony. Rather than addressing
18 this concern by an adjustment to test year rate base as Staff (and RUCO) had originally
19 proposed, the Settlement Agreement addresses this concern prospectively by providing for
20 a rate case moratorium (in Section X) and for depreciation rates (in Section V) for TEP's
21 generating plant that include \$21.6 million per year on an ACC jurisdictional basis for cost
22 of removal accruals. Consequently, during the rate moratorium period, this provision will
23 provide future ratepayer benefit by building up the balance of Accumulated Depreciation
24 related to accruals for cost of removal on TEP's generating plant in a manner that may not
25 have been achievable without the Settlement.

1 **Q. Would this result have been possible outside the context of the Settlement**
2 **Agreement?**

3 A. I don't believe it would have been. I believe that Staff's litigation position regarding the
4 depreciation issues is well-reasoned and appropriate, but I also recognize that TEP's
5 position might be regarded as reasonable by some. Addressing this matter by a
6 prospectively-applied remedy, as provided in the Settlement, eliminates the potential for
7 write-offs on TEP's financial statements and/or potentially having to re-state prior years'
8 financial statements. It also addressed Staff's concerns about building up the
9 Accumulated Depreciation balance before TEP's next rate case.

10
11 **Q. Is the compromise reached on Accumulated Depreciation and Depreciation-rate**
12 **issues reasonable in the context of the Settlement Agreement?**

13 A. I do believe it is a reasonable solution in the context of the Settlement Agreement because
14 it takes into account both sides of the litigation issues that were raised by Staff and TEP.
15 The Settlement Agreement resolves a very contentious issue and, at the same time,
16 provides a prospective benefit to ratepayers by building up the balance of Accumulated
17 Depreciation related to accruals for cost of removal in a manner that may not have been
18 achievable without the Settlement.

1 ***Springerville Unit 1***

2 **Q. RUCO witness Rigsby's responsive direct testimony at page 13, line 11, through page**
3 **14, line 20, discusses the Springerville Unit 1 issue. At page 13, lines 21-23. Mr.**
4 **Rigsby states that: "A full discussion of the Staff's position can be found in the**
5 **direct testimony of Ralph C. Smith at pages 49-52." Is that a full discussion?**

6 **A. Although I discussed the issue in my direct testimony, I also discussed Springerville 1**
7 **issues in my March 10, 2008 deposition, the transcript of which was filed with my June**
8 **11, 2008 direct testimony in support of the settlement as Attachment RCS-8.**

9
10 **Q. Did TEP provide estimates of cost-based recovery for Springerville Unit 1 in its**
11 **rebuttal?**

12 **A. Yes. TEP witness Kissinger addressed Springerville Unit 1 cost-based recovery in her**
13 **rebuttal testimony.**

14
15 **Q. Was TEP's rebuttal testimony considered by Staff in arriving at reasonable**
16 **compromises for settlement purposes?**

17 **A. Yes.**

18
19 **Q. What acknowledgement does RUCO witness Rigsby make of TEP's rebuttal**
20 **testimony in his criticisms of the Settlement Agreement?**

21 **A. Virtually none. On issues such as Springerville Unit 1, Accumulated Depreciation, etc.,**
22 **Mr. Rigsby acknowledges TEP's original filing and the Staff and RUCO direct testimony,**
23 **but fails to mention or address the related issues that were presented in TEP's rebuttal**
24 **testimony.**

25

1 **Q. At pages 13-14 of his responsive testimony, RUCO witness Rigsby appears to be**
2 **criticizing Staff for moving from a \$15 per kilowatt-month cost to \$25.67 per**
3 **kilowatt-month amount for Springerville Unit 1. Why was Staff willing to accept this**
4 **adjustment?**

5 **A. For two reasons.**

6
7 First, in Staff's direct filing, I had used a \$15 per kilowatt-month fixed cost
8 recovery rate. This was based in large part on my understanding at that time of Decision
9 No. 56659 (October 24, 1989), which had required TEP to adjust the revenue requirement
10 effect of Springerville Unit 1 to reflect a \$15 per kilowatt-month fixed cost recovery rate
11 that reflected the cost of long-term generation capacity reasonably available at the time of
12 that prior TEP rate case. The ratemaking treatment of Springerville Unit 1 was an
13 important subject discussed during my deposition (see Attachment RCS-8). At the time of
14 filling my direct testimony, I was not aware of Commission Decision No. 57586, which
15 was issued in 1991 (i.e., after Decision No. 56659), and which provided as follows in
16 Finding of Fact 10.q: "In future rate cases the Commission shall determine the
17 appropriate level of the Century demand charge based upon reasonable market prices, but
18 in no event will the rate be lower than the rate allowed in Decision 56659, or \$15 per
19 kilowatt month." Consequently, Staff was already considering a substantial revision in its
20 direct filed position on Springerville Unit 1 when the schedule for filing surrebuttal
21 testimony in this case was suspended.

22
23 Second, the Settlement Agreement provides at paragraph 3.2 on page 7 that:

24
25 *Recovery of Springerville Unit 1 non-fuel costs shall reflect a cost of \$25.67 per*
26 *kW month which approximates the levelized cost of Springerville Unit 1 through*
27 *the remainder of the primary lease term for this generating facility. In addition,*

1 *Springerville Unit 1 leasehold improvements shall be included in TEP's original*
2 *rate base at net book value as of December 31, 2006.*

3
4 Consequently, the intent of the settling parties is to provide Springerville Unit 1, including
5 leasehold improvements, in rates at cost. The \$25.67 was originally presented by TEP as
6 a market-based rate, but according to the terms of the Settlement Agreement, this number
7 is used as an approximation of the Springerville Unit 1 lease-related non-fuel levelized
8 cost. In my opinion, this result is reasonable in light of TEP's rebuttal testimony and
9 TEP's responses to data requests concerning Springerville Unit 1 cost.

10
11 **Q. At page 13, line 23, through page 14, line 1, Mr. Rigsby states that: "RUCO's**
12 **position on this issue was that Springerville Unit 1 should be included in rates at its**
13 **embedded cost." Please respond.**

14 **A.** Mr. Rigsby does not appear to acknowledge that RUCO's reflection of Springerville Unit
15 1 may have been incomplete, and thus not an accurate reflection of cost. He does not
16 appear to acknowledge TEP's rebuttal testimony on Springerville Unit 1 issues. For
17 example, TEP witness Kissinger's rebuttal testimony suggests that the levelized cost of
18 Springerville Unit 1 was higher than had been reflected by RUCO. As noted above, the
19 Settlement agreement attempts to achieve the objective articulated by RUCO of including
20 Springerville Unit 1 in rates at cost. It did this by including the leasehold improvements in
21 rate base and by using an amount for lease-related non-fuel expenses that approximated
22 the levelized cost.

1 **Q. At page 14, lines 12-19, of his responsive testimony, Mr. Rigsby appears to have a**
2 **problem with describing the Springerville Unit 1 settlement provisions as “cost based**
3 **recovery.” Please respond.**

4 **A.** While the \$25.67 per kilowatt month was originally presented by TEP an estimated
5 market price; as explained above, the settling parties have used this amount as an
6 approximation of the levelized cost. The use of an estimate of levelized cost for
7 settlement purposes in conjunction with the use of a cost-of-service revenue requirement
8 methodology is fair and reasonable under the circumstances.

9
10 ***Overall Settlement***

11 **Q. As evidenced by Mr. Rigsby’s testimony and his Exhibit WAR-1, one of RUCO’s**
12 **main concerns appears to be that the Settlement Agreement provides for an amount**
13 **of base rate increase that was agreed to by the signing parties and also includes a**
14 **PPFAC that could result in further rate increases. Is that a valid reason for rejecting**
15 **the settlement?**

16 **A.** I don’t believe so. As explained above, the Settlement Agreement specifies the amount of
17 base rate increase from two different bases: (1) a \$47.1 million increase from TEP’s
18 current rates including Fixed CTC/True-Up Revenue and (2) a \$136.8 million increase
19 from TEP’s current base rates without Fixed CTC of \$691.5 million. This is presented in
20 paragraphs 2.3 and 2.4, respectively. The Settlement Agreement is also clear that the base
21 cost of fuel and purchased power is \$0.0028896 per kWh, and that there is a PPFAC,
22 which is presented in detail in Exhibit 6. Consequently, to me, the fact that the Settlement
23 Agreement provides for a base rate increase and a PPFAC that would result in subsequent
24 rate changes does not appear to be a reason for rejecting it.

1 **Q. Do you have any opinion as to whether the overall Settlement Agreement results in**
2 **fair and reasonable rates?**

3 A. Yes. While I have focused my efforts primarily on certain aspects of the Settlement
4 Agreement, including the reconciliation of the revenue requirement and the PPFAC, it
5 represents significant compromises by both Staff and TEP in terms of the agreed-upon
6 base rate revenue level of \$828.2 million. Moreover, the Settlement Agreement has other
7 beneficial provisions such as a four-year rate moratorium (in Section X), specificity
8 concerning the use of a cost-of-service based methodology (in paragraph 2.2) and a waiver
9 of potential litigation related to the 1999 Settlement Agreement (in Section XIV). Overall,
10 the Settlement Agreement resolves a wide range of contested issues in a fair and
11 reasonable manner that would eliminate potentially lengthy and costly future litigation.⁷

12
13 **III. TECHNICAL CORRECTION TO TEP'S RULES AND REGULATIONS ON LINE**
14 **EXTENSIONS**

15 **Q. Would Staff like to see a relatively minor wording revision to TEP's Rules and**
16 **Regulations at Section 7 concerning Line Extensions in the final Commission-**
17 **approved version of the Settlement?**

18 A. Yes. TEP's Rules and Regulations draft at page 58 of 105, in Section 7, Line Extensions⁸,
19 contains the following provision under subsection D. Construction / Facilities Related
20 Income Taxes:

21
22 "Any federal, state or local income taxes resulting from the receipt of a
23 contribution in aid of construction in compliance with this rule is the responsibility
24 of the Company and will be recorded as a deferred tax asset and reflected in the
25 Company's rate base." (Emphasis supplied.)

⁷ Another Staff witness addresses how the Settlement Agreement resolves issues lingering from the 1999 Settlement Agreement and avoids potential litigation.

⁸ See Attachment RCS-10, which reproduces that page for ease of reference.

1 It is unnecessary for TEP's Line Extension rules to specify such a rate base treatment.
2 Consequently, similar to an issue that arose in the recent UNS Electric rate case, Staff
3 would like to have the last seven words "and reflected in the Company's rate base"
4 removed from this provision.

5
6 **Q. Does this conclude your Rebuttal Testimony?**

7 **A. Yes, it does.**

TUCSON ELECTRIC POWER COMPANY
Average Base Cost of Fuel and Purchased Power

FERC Account	TEP Adjusted Total	TEP Adjusted ACC Jurisdiction Amount	Jurisdictional Percent	Adjusted Total Per Settlement	Adjusted ACC Jurisdictional	Differences in Total Amounts
501	\$ 239,090,289.98	\$ 214,137,539.47	0.895634614	\$ 216,920,289.98	\$ 194,281,320	\$ (22,170,000.00)
547	\$ 26,864,965.52	\$ 24,061,193.01	0.895634613	\$ 26,864,965.52	\$ 24,061,193	\$ -
565	\$ 4,771,517.47	\$ 4,510,725.20	0.945343956	\$ 4,771,517.47	\$ 4,510,725	\$ -
555-D	\$ 30,633,600.00	\$ 28,959,288.61	0.945343956	\$ 13,739,600.00	\$ 12,988,648	\$ (16,894,000.00)
555-E	\$ 40,035,093.60	\$ 35,856,815.58	0.895634613	\$ 37,330,093.60	\$ 33,434,124	\$ (2,705,000.00)
TOTAL	\$ 341,395,466.57	\$ 307,525,561.87		\$ 299,626,466.57	\$ 269,276,010.00	\$ (41,769,000.00)

Total cost of fuel and PP in PPFAC Includible Accounts \$ 307,525,561.87
Sales, Adjusted kWhs 9,318,849,104

Base Cost of Fuel and Purchased Power per TEP \$ 0.033000 \$/kWH
Average Base Cost of Fuel and PP \$ 0.028896 \$/kWH

Staff Adjustments	No.	Fuel Expense Acct. 501	Purchased Power -	
			Demand Acct. 555-D	Energy Acct. 555-E
Springerville Unit No. 1	C-1			
Luna Plant	C-2		\$ (15,960)	
Luna Facility Depreciation and Property Tax Expense	C-3			
San Juan Coal Contract	C-4	\$ (9,884)		
Bad Debt Expense	C-5			
Edison Electric Institute Dues	C-6			
Incentive Compensation	C-7			
SERP Expense	C-8			
Workers' Compensation Expense	C-9			
Short Term Sales	C-10			
Wholesale Trading Activity	C-11			
Gain on SO2 Allowances	C-12			
Property Tax Expense	C-13			
Interest Synchro- nization	C-14			
Depreciation Rates Adjustment	C-15			
Customer Care & Billing System	C-16			
Markup Above Cost for Charges from Affiliate SES	C-17			
Normalize Affiliate Charges to TEP	C-18			
PPFAC Adjustment	C-19	\$ (12,286)	\$ (934)	\$ (2,705)
Implementation Cost Regulatory Asset	C-20			
Legal Expense Related to Motion to Amend D.62103	C-21			
Legal Expense Related to California Proceedings	C-22			
Postage Expense	C-23			
West Connect Charges Related to Regulatory Asset	C-24			
Total Staff Adjustments Affecting PPFAC Accounts 501, 547, 555 and 565		\$ (22,170)	\$ (16,894)	\$ (2,705)

Tucson Electric Power Company

Rules & Regulations

SECTION 7 LINE EXTENSIONS (continued)

D. Construction / Facilities Related Income Taxes

Any federal, state or local income taxes resulting from the receipt of a contribution in aid of construction in compliance with this rule is the responsibility of the Company and will be recorded as a deferred tax asset and reflected in the Company's rate base.

However, if the estimated cost of facilities for any line extension exceeds \$500,000, the Company shall require the Applicant to include in the contribution an amount (the "gross up amount") equal to the estimated federal, state or local income tax liability of the Company resulting from the contribution, computed as follows:

$$\text{Gross Up Amount} = \frac{\text{Estimated Construction Cost}}{(1 - \text{Combined Federal-State-Local Income Tax Rate})}$$

After the Company's tax returns are completed, and actual tax liability is known, to the extent that the computed gross up amount exceeds the actual tax liability resulting from the contribution, the Company shall refund to the Applicant an amount equal to such excess, or collect the additional amount from the Applicant. When a gross-up amount is to be obtained in connection with an extension agreement, the contract will state the tax rate used to compute the gross up amount, and will also disclose the gross-up amount separately from the estimated cost of facilities. In subsequent years, as tax depreciation deductions are taken by the Company on its tax returns for the constructed assets with tax bases that have been grossed-up, a refund will be made to the Applicant in an amount equal to the related tax benefit. In lieu of scheduling such refunds over the remaining tax life of the constructed assets, a reduced lump sum refund may be made at the end of five (5) years at the election of either the Company or the Applicant. This lump sum payment shall reflect the net present value of remaining tax depreciation deductions discounted at the Company's authorized rate of return.

E. Transition Period for Elimination of Free Footage

From the effective date of these Rules and Regulations, there is a six (6) month grace period for Customers, developers and subdividers to execute a line extension agreement or receive approval on a new service application from the Company in order to be eligible for the line extension policy in effect between March 14, 2000 and Those new applicants must make provisions for the Company to install and energize the extension and service facilities within eighteen (18) months from the date of their respective agreement and/or application. In addition, all existing approved line extension agreements and service applications will be grandfathered in under the policy in effect from March 14, 2000 to Grandfathered Customers must make provisions for the Company to install and energize the extension and service facilities within eighteen (18) months from the effective date of these Rules and Regulations or they will be subject to the new line extension policy.

Filed By:	Raymond S. Heyman	Tariff No.:	Rules & Regulations
Title:	Senior Vice President and General Counsel	Effective:	DRAFT
District:	Entire Electric Service Area	Page No.:	Page 58 of 105

Keene

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-01933A-07-0402
TUCSON ELECTRIC POWER COMPANY FOR)
THE ESTABLISHMENT OF JUST AND)
REASONABLE RATES AND CHARGES)
DESIGNED TO REALIZE A REASONABLE)
RATE OF RETURN ON THE FAIR VALUE OF)
ITS OPERATIONS THROUGHOUT THE STATE)
OF ARIZONA.)
IN THE MATTER OF THE FILING BY TUCSON) DOCKET NO. E-01933A-05-0650
ELECTRIC POWER COMPANY TO AMEND)
DECISION NO. 62103.)

REBUTTAL TESTIMONY

SUPPORTING THE SETTLEMENT AGREEMENT

OF

BARBARA KEENE

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 8, 2008

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**EXECUTIVE SUMMARY
TUCSON ELECTRIC POWER COMPANY
DOCKET NOS. E-01933A-07-0402 AND E-01933A-05-0650**

This rebuttal testimony addresses Staff's response to the direct testimony of Mr. Jeff Schlegel of the Southwest Energy Efficiency Project in regard to DSM program spending increases and a Performance Incentive.

1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Barbara Keene. My business address is 1200 West Washington Street,
4 Phoenix, Arizona 85007.

5
6 **Q. Have you previously filed testimony in this docket in support of the Settlement
7 Agreement?**

8 A. Yes. I filed direct testimony in support of the Settlement Agreement on June 11, 2008.

9
10 **Q. As part of your employment responsibilities, were you assigned to review the
11 testimonies of other parties in this docket?**

12 A. Yes.

13
14 **Q. What is the subject matter of this testimony?**

15 A. This testimony will address Staff's response to the direct testimony of Mr. Jeff Schlegel of
16 the Southwest Energy Efficiency Project.

17
18 **RESPONSE TO THE DIRECT TESTIMONY OF MR. JEFF SCHLEGEL**

19 **Q. What does Mr. Schlegel propose in his direct testimony?**

20 A. Mr. Schlegel proposes that the spending levels for Commission-approved DSM programs
21 be able to increase between rate cases without Commission pre-approval. Tucson Electric
22 Power ("TEP") would notify the Commission and Staff of the DSM program spending
23 increase, and the Commission could choose whether or not to take action.

1 **Q. Is Staff opposed to increasing spending levels of DSM programs between rate cases?**

2 A. No. Staff is not opposed to additional reasonable spending on DSM if the Commission
3 finds it appropriate. However, the Commission needs to determine what oversight it
4 wants.

5
6 **Q. Should there be flexibility in TEP's DSM budget?**

7 A. Flexibility has some value, but there should be some limitation on that flexibility. The
8 level of flexibility needs to be reviewed in the overall context of the budget.

9
10 **Q. What has the Commission approved for other utilities in regard to DSM budget
11 flexibility?**

12 A. A couple of examples show a range of DSM budget flexibility. Arizona Public Service
13 cannot increase its total DSM budget without Commission approval, while UNS Gas can
14 increase its total DSM budget up to 25 percent before needing Commission approval.

15
16 **Q. Is there another issue mentioned in Mr. Schlegel's testimony on which Staff would
17 like to comment?**

18 A. Yes. Mr. Schlegel mentioned that the Settlement Agreement does not explicitly address a
19 DSM performance incentive.

20
21 **Q. What does the Settlement Agreement say in regard to a performance incentive?**

22 A. Section 9.3 of the Settlement Agreement states "TEP's DSM adjustor mechanism shall
23 include a performance incentive as recommended by Staff in its Direct Rate Design
24 Testimony."

1 **Q. Please describe the DSM Performance Incentive as recommended by Staff.**

2 A. The Performance Incentive would allow both customers and TEP to share the overall net
3 benefits of DSM. Customers would receive 90 percent and TEP would receive 10 percent
4 of the net benefits of the DSM portfolio, excluding the Low-Income Weatherization
5 program, the Educational and Outreach program, and the Direct Load Control program.
6 The net benefits would be verified through measurement and evaluation. The
7 Performance Incentive would be capped at 10 percent of reporting period DSM spending.

8

9 **Q. Does this conclude your rebuttal testimony?**

10 A. Yes, it does.

11